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Supreme Court, U.S.
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No. 97-385

In the Supreme Court of the United States

OCTOBER TERM, 1997

JOHN B. WELLS, PETITIONER

v.

HERSHEL W. GOBER,
ACTING SECRETARY OF VETERANS AFFAIRS

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether a veteran who sold his mortgaged property and allowed the buyers to assume his loan, which the Department of Veterans Affairs (VA) had guaranteed, was entitled to notice of his buyers' default and the VA's payment on the guaranty—which prevents restoration of the veteran's previously used loan-guaranty benefits until repayment of the VA's loss—where the veteran had no right under state law to intervene upon default to prevent the loss.

2. Whether the VA's payment of a guaranty claim upon acceptance of a deed in lieu of foreclosure constitutes a "loss" as that term is used in 38 U.S.C. 3702(b), which provides for the restoration of expended home-loan guaranty benefits.

3. Whether the Soldiers' and Sailors' Civil Relief Act of 1940, 50 U.S.C. App. 501 *et seq.*, proscribes the VA's approval of a mortgage holder's acceptance of a deed in lieu of foreclosure from a defaulting home buyer who had purchased the property from, and assumed the mortgage debt of, a person still on active military duty.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-7) is unreported, but the decision is noted at 114 F.3d 1207 (Table). The opinion of the Court of Veterans Appeals (Pet. App. 8-35) is reported at 9 Vet. App. 293. The opinion of the Board of Veterans Appeals (Pet. App. 36-43) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on June 6, 1997. The petition for a writ of certiorari was filed on September 2, 1997. This Court's jurisdiction is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Department of Veterans Affairs (VA) guarantees loans made to veterans[1] by private lenders for, among other things, the purchase of a dwelling to be owned and occupied by the veteran as the veteran's home. 38 U.S.C. 3710(a)(1); *Rank* v. *Nimmo*, 677 F.2d 692, 694 (9th Cir.), cert. denied, 459 U.S. 907 (1982). "[T]he [VA's] guaranty * * * operate[s] as the substantial equivalent of a down-payment * * * by the veteran * * * in order to induce prospective mortgagee-creditors to provide 100% financing for a veteran's home." *United States* v. *Shimer*, 367 U.S. 374, 383 (1961).

The guaranty on a particular loan may not exceed the guaranty entitlement available to the veteran. 38 U.S.C. 3703(a)(1)(A)(ii). The statute gives eligible veterans an initial, total loan guaranty entitlement of $36,000 for loans up to $144,000, and $50,750 for loans exceeding that amount. 38 U.S.C. 3703(a)(1)(B). That initial entitlement is reduced by the amount of benefits previously used by the veteran, unless they have been restored pursuant to 38 U.S.C. 3702(b). *Ibid.*

Section 3702(b) provides, in relevant part, that in computing the amount of previously used loan benefits to be deducted from a veteran's total remaining entitlement,

> the Secretary may exclude the amount of guaranty * * * housing loan entitlement used for any guaranteed * * * loan under the following circumstances:

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[1] The term "veteran" includes individuals serving on active duty in the armed services. 38 U.S.C. 3701(b)(4).

> (1)(A) The property which secured the loan has been disposed of by the veteran or has been destroyed by fire or other natural hazard; and
>
> (B) the loan has been repaid in full, or the Secretary has been released from liability as to the loan, *or if the Secretary has suffered a loss on such loan, the loss has been paid in full.*
>
> (2) A veteran-transferee has agreed to assume the outstanding balance on the loan and consented to the use of the veteran-transferee's entitlement, to the extent that the entitlement of the veteran-transferor had been used originally, in place of the veteran-transferor's for the guaranteed * * * loan, and the veteran-transferee otherwise meets the requirements of this chapter.

38 U.S.C. 3702(b) (emphasis added). Thus, if the veteran has disposed of the property, but the VA has suffered a loss on the loan, the statute does not authorize the Secretary to restore the loan guaranty amount until the loss is repaid.[2] The statute further

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[2] The corresponding regulation similarly provides that the Secretary may exclude the amount of guaranty * * * entitlement used for any guaranteed * * * loan provided:

> (1) The property which served as security for the loan has been disposed of by the veteran, or has been destroyed by fire or other natural hazard; and
>
> (2)(i) The loan has been repaid in full or the Secretary has been released from liability as to the loan, or if the Secretary has suffered a loss on said loan, such loss has been paid in full;
>
> * * * * *

38 C.F.R. 36.4302(j).

provides, however, that the "Secretary may, in any case involving circumstances the Secretary deems appropriate, waive one or more of the conditions prescribed in paragraph (1). 38 U.S.C. 3702(b).

2. In 1978, petitioner, then on active duty in the Navy, purchased a home in Chesapeake, Ohio, financed by a $58,500 loan. The VA guaranteed 29.91% of that loan, up to $17,500. As a result, petitioner's VA loan guaranty entitlement was reduced by $17,500. Pet. App. 2-4, 26.

In 1979, petitioner sold the property to Roy G. Osborn and Shirley D. Stamper, who assumed the outstanding guaranteed loan. Pet. App. 9, 26. Osborn apparently was a veteran, but he did not substitute any VA loan guaranty entitlement he may have had for petitioner's loan guaranty entitlement, as allowed by 38 U.S.C. 3702(b)(2). *Id.* at 26. In July 1981, Osborn and Stamper defaulted on the loan. Shortly thereafter, they offered to tender a deed in lieu of foreclosure to the loan holder, First Family Mortgage Corporation. *Id.* at 3.

In February 1982, the VA notified First Family that the VA had approved First Family's acceptance of a deed in lieu of foreclosure, in exchange for First Family's release of the borrower from all personal liability on the note. Pet App. 3; Rec. Doc. No. 32.[3] As provided by statute and regulation, the VA set a "net value" of the property (fair market value less certain costs the VA expected to incur) to be credited against the outstanding debt. 38 U.S.C. 3732(c)(1)(C); 38 C.F.R. 36.4320(c). The net value of the property was set at $58,620, and First Family subsequently deeded

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[3] "Rec. Doc." refers to documents in the Designation of Record filed in the court of appeals.

the property to the VA for that value. Rec. Doc. No. 27. In February 1983, the VA notified First Family that it had approved the payment of a guaranty claim to First Family in the amount of $5,539.67. Pet. App. 3.

There is now a regulatory requirement that the loan holder notify the "original veteran-borrower" when it notifies the VA of its intention to foreclose. 38 C.F.R. 36.4317(c). No such regulation existed, however, during the period of the transactions at issue in this case. Pet. App. 20. Petitioner claims that he had no notice or knowledge of the default by Osborn and Stamper, or the tender and acceptance of the deed in lieu of foreclosure, or the VA's payment of the $5,539.67 guaranty claim. Petitioner learned of those events when he was informed that the VA would not restore the $17,500 of loan guaranty entitlement he used to obtain the 1978 loan until the VA's $5,539.67 loss on that loan had been repaid. Pet. App. 3-4. See 38 U.S.C. 3702(b).[4]

3. Petitioner objected to the VA's decision not to restore the $17,500 of his loan guaranty benefits that he had previously used, and he appealed to the Board of Veterans Appeals, which denied his request. Pet. App. 36-43. Petitioner then appealed to the Court of Veterans Appeals, which affirmed. *Id.* at 8-35. The Court of Veterans Appeals held that petitioner did not have a property interest in the restoration of his expended loan guaranty entitlement, *id.* at 21-28, or a state-law equitable right of redemption of the real property for which the deed in lieu of foreclosure had been tendered, *id.* at 28-33. Accordingly, the court

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[4] Petitioner may, however, use the remainder of his VA loan guaranty entitlement.

concluded he was not entitled to advance notice of the tender and acceptance of the deed in lieu of foreclosure. *Id.* at 9. Finally, the court rejected petitioner's contention that the Soldiers' and Sailors' Civil Relief Act of 1940, 50 U.S.C. App. 501 *et seq.*, barred the VA from approving First Family's acceptance of the deed in lieu of foreclosure while he was on active duty. Pet. App. 33.

4. The Court of Appeals for the Federal Circuit affirmed, Pet. App. 1-7, holding that petitioner had "neither demonstrated that he retained a property interest in the restoration of his expended VA home loan guaranty entitlement nor retained an equitable right of redemption." *Id.* at 2. After identifying the statutory conditions for restoration of previously used VA home loan guaranty benefits, the court of appeals found that once petitioner "utilized his original guaranty benefits, he had a mere unilateral expectation of repaying his loan, and thus, according to the terms of § 3702(b), had a mere unilateral expectation of restoring his full guaranty benefits." *Id.* at 6. Relying upon *Board of Regents* v. *Roth*, 408 U.S. 564 (1972), and *Goldberg* v. *Kelly*, 397 U.S. 254 (1970), the court held that petitioner "had no legitimate claim of entitlement grounded in the statute defining eligibility for the restoration of his full VA home loan guaranty." Pet. App. 6. The court further determined that because petitioner "did not retain an equitable right of redemption after he sold his home to Osborn," there was no need to "consider whether such an interest is a property interest protected by the due process clause of the Constitution." *Id.* at 7.

ARGUMENT

Petitioner contends that the VA had a duty to notify him of his buyers' default, so that he could act to cure that default and prevent its effect on the eventual restoration of his expended loan guaranty benefits. Petitioner argues that, without such notice, his due process rights were violated by the VA's insistence that the amount it paid to First Family as a result of the default on the loan must be reimbursed before petitioner's used benefits could be restored. The court of appeals correctly rejected that argument. The unpublished decision of the court below conflicts with no decision of this Court or of any other court of appeals, and it presents no issue of continuing importance in light of the VA regulation that now provides for the private lender to notify the veteran before foreclosing on a guaranteed loan that has been assumed by a subsequent purchaser. See page 5, *supra*. Petitioner's claim therefore warrants no further review.

1. a. The court of appeals found that petitioner had no constitutionally protected property interest in the restoration of his benefits. This Court need not reach that question, however, because even if petitioner did have such an interest, he received any process due to protect it.[5] To the extent petitioner had a property

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[5] The court of appeals' conclusion that petitioner had no protectible property interest in eligibility for restoration of full VA loan benefits is, however, consistent with this Court's precedents. To possess a Fifth Amendment property interest in an economic benefit, an individual "must have more than an abstract need or desire for it * * * [or] a unilateral expectation of it." *Board of Regents* v. *Roth*, 408 U.S. 564, 577 (1972). A statute or regulation creates a constitutionally protected property interest in benefits only if it places "substantive

interest in the future restoration of his previously used loan guaranty benefits, the options available for protecting that interest at the time he sold the property provided all the process constitutionally due.

There were several ways in which petitioner could have protected the restoration of his guaranty benefits. Under 38 U.S.C. 3702(b)(2), used benefits may be restored when the property is transferred if "[a] veteran-transferee has agreed to assume the outstanding balance on the loan and consented to the use

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limitations on official discretion" in awarding those benefits. *Olim* v. *Wakinekona*, 461 U.S. 238, 249 (1983). Restoration of petitioner's expended loan guaranty amount is controlled by 38 U.S.C. 3702(b) and 38 C.F.R. 36.4302(j). Those sections provide only that, if certain criteria are met, "the Secretary *may* exclude the ~~amount~~ of guaranty" used for that loan when deducting used benefits from the veteran's total entitlement (emphasis added). Moreover, the waiver clause in 38 U.S.C. 3702(b) grants discretionary authority to restore benefits where the conditions have not been met. Thus the statute and regulations do not on their face limit administrative discretion so as to create a property interest in benefit restoration. The VA informs us that, in practice, whenever the criteria listed in those sections are met, the Secretary restores the veteran's original entitlement. This Court has indicated that in the state employment context, "policies and practices" might in some circumstances give rise to a constitutionally protected property interest, where an employee had come to rely on such an understanding. *Perry* v. *Sindermann*, 408 U.S. 593, 603 (1972). That rationale has not been extended to other contexts, see, *e.g.*, *Washington Legal Clinic for the Homeless* v. *Barry*, 107 F.3d 32, 38 (D.C. Cir. 1997) (noting that, outside the employment context, no federal circuit court has held that administrative understandings, wholly apart from legislation or regulations, may create a constitutionalized property interest); compare *Ruckelshaus* v. *Monsanto Co.*, 467 U.S. 986, 1005-1011 (1984), and petitioner in any event does not claim that he relied on any such policy or practice.

of the veteran-transferee's entitlement, to the extent that the entitlement of the veteran-transferor had been used originally * * * for the guaranteed * * * loan." One of petitioner's buyers, Osborn, apparently was a veteran. Pet. App. 10. Assuming Osborn retained sufficient VA loan guaranty entitlement, petitioner could have made the sale of the property contingent upon Osborn's substituting his own eligibility for the VA loan guaranty, thus allowing immediate restoration of petitioner's original benefits. As the Court of Veterans Appeals noted, however, petitioner "did not take any steps to ensure that Mr. Osborn would substitute his eligibility" for the loan guaranty. *Id.* at 26.

If the buyers were not in a position to substitute their own loan guaranty entitlement for petitioner's, there were other ways in which petitioner could have protected any future interest in having his original benefits restored. Rather than allowing the buyers to assume the mortgage, he could have required them to obtain their own financing and pay off the VA-guaranteed mortgage at the time of the sale. Under 38 U.S.C. 3702(b)(3)(A), that arrangement would have allowed restoration of petitioner's used loan guaranty benefits as soon as he transferred the property. Even if petitioner's buyers assumed primary responsibility for his mortgage, he could have structured the conveyance to ensure that he would at least have an opportunity, upon their default, to regain possession of the property and control of the debt. For example, he might have reserved a right to notice and first refusal on sale of the land. Petitioner chose instead to deed away his entire property interest, have the buyers assume the mortgage, and let the chips fall where they may.

In short, by allowing his 30-year loan to be assumed—without substituting the purchaser's VA loan guaranty entitlement for his own, maintaining any interest in the property, or requiring either the buyers or First Family to notify him in the event of a default—petitioner accepted the risk that his buyers' actions would determine the future restoration of his original loan benefits.[6] Under these circumstances, the VA was not constitutionally required to keep petitioner apprised of how his buyers' handling of his debt affected the potential future restoration of the benefits he had used to guarantee that debt.

b. The decision below does not conflict with decisions cited by petitioner that have required notice of foreclosure before allowing the VA to pursue a veteran for a loss caused by the default of a home buyer who assumed the veteran's mortgage. See *Vail* v. *Derwinski*, 946 F.2d 589 (8th Cir. 1991); *United States* v. *Whitney*, 602 F. Supp. 722 (W.D.N.Y. 1985); *United States* v. *Murdock*, 627 F. Supp. 272 (N.D. Ind. 1985). The courts in those cases held that the VA could not proceed against the veteran to recoup a deficiency from a foreclosure sale, when the VA had not attempted to notify the veteran of the default and foreclosure that led to the loss. Here, however, the VA is not trying to collect a debt from petitioner. It is one thing to hold that the VA may not withhold veterans' disability checks to make up deficiencies arising from foreclosures of which the veterans had

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[6] Even if the buyers had made all of the mortgage payments on time, the loan would not have been paid off (thereby making restoration possible) until October 1, 2008. Pet. App. 27. If the buyers had been late with payments, or renegotiated the time frame of the loan, restoration of petitioner's benefits would have been further delayed.

no notice. See *Vail*, 946 F.2d at 594. It would be an entirely different matter to hold that a veteran has a right to automatic restoration of his depleted loan benefits because he was not notified of his purchasers' default.[7]

2. The court of appeals also examined Ohio law and concluded that petitioner had no right of redemption under state law that could, in turn, furnish the basis for a claim that the VA had a duty to notify him of the buyers' default. Pet. App. 6-7. Even if petitioner had retained a state-law right that would have allowed him to intervene in the conveyance of the deed in lieu of foreclosure and to redeem the property, it by no means follows that the VA, rather than the mortgagee (First Family), would have had the duty to notify petitioner. And it is far from clear that the VA's failure to notify petitioner of his opportunity to exercise any rights he might have had under *state* law would trigger a right in petitioner to restoration of his loan guaranty entitlement under *federal* law. In any case, the court below correctly found that petitioner retained no "equity of redemption" under state law—*i.e.*, that he had no right to redeem the property

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[7] The one other court of appeals to interpret the statutory section governing restoration of benefits also drew a line between a veteran's right to avoid a debt owed to the VA as a result of a loan default and his right to restoration of benefits. See *Dixon* v. *United States*, 68 F.3d 1253, 1257 (10th Cir. 1995), cert. denied, 116 S.Ct. 1566 (1996). In *Dixon*, a veteran whose debt to the VA was discharged in bankruptcy argued that his full original loan guaranty entitlement should be restored as a result. The court rejected that contention, holding that the veteran was "simply not eligible for the full amount of guaranty benefits until the loss incurred by the VA is repaid." *Ibid.*

by paying the debt upon his purchasers' default. *Id.* at 7.

Under Ohio law, a mortgagor who sells his entire interest in real property, as petitioner did when he conveyed the property by warranty deed and his purchasers assumed the mortgage, passes his equity of redemption to his buyers. See *Carter* v. *Walker*, 2 Ohio St. 339 (1853) (where grantee by deed had agreed to pay off mortgage, he held equity of redemption; grantor had no remaining interest in land and would not be necessary party to foreclosure sale); see also 69 Ohio Jur. 3d *Mortgages* § 251, at p. 303 (1986); *Hembree* v. *Mid-America Federal Sav. & Loan Ass'n.*, 580 N.E.2d 1103, 1111 (Ohio Ct. App. 1989) ("A vendee in a contract of sale acquires his vendor's equity of redemption and has the right to redeem the mortgaged premises."). When petitioner sold the property, his equity of redemption was acquired by his buyers; he had no right to intervene in their conveyance to the mortgage holder of the deed in lieu of foreclosure.[8]

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[8] To be sure, after he sold the property, petitioner remained liable on the mortgage note as a surety. *Walser* v. *Farmers' Trust Co.*, 185 N.E. 535, 538 (Ohio 1933) ("[W]here the grantee of a parcel of real estate, as part of the purchase price thereof, assumes to pay a debt secured thereon by a mortgage—the grantor being also personally bound for the payment—such assumption, as between the grantor and grantee, constitutes the grantee the principal debtor, and the grantor his surety.") When First Family accepted the deed in lieu of foreclosure, however, it released petitioner from any personal liability on the mortgage note, although it retained the right to file a claim with the VA under the guaranty. Rec. Docs. 26, 32; Pet. App. 10-11. Petitioner has cited no authority for the proposition that his rights of indemnity and subrogation as a surety would have entitled him to prevent a conveyance

Here the owners of a fee simple interest in real property voluntarily deeded the property to the private mortgage holder (First Family). Although the VA, as partial guarantor of the loan, authorized First Family to accept the deed in lieu of foreclosure, that authorization did not give the VA a duty to notify petitioner of his buyers' default. Moreover, since petitioner had no state-law right of redemption, even if he had received notice of the default, he would have had no legal right to intervene in the conveyance of the deed in lieu of foreclosure.[9]

3. Petitioner contends, however, that in conditioning restoration of full loan benefits—after "the Secretary has suffered a loss" on a loan—on full repayment of the loss, see 38 U.S.C. 3702(b)(1)(B), Congress did not intend to include payment of a guaranty claim after authorizing acceptance of a deed in lieu of foreclosure. He argues first that the term "loss," as used in the statute, should be narrowly defined as "[d]estruction through natural disasters," and should not include a financial loss on a loan guaranty. Pet. 9. That contention finds no support in the cases petitioner cites, which define "loss" in contexts other than a loan, a loan guaranty, or a similar financial transaction.[10] In fact, a Senate Report addressing VA

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that released him from all the liability of suretyship. See Pet. 4. In any event, the court below found no such right.

[9] Petitioner has raised no claim of any right to notification of the VA's subsequent sale of the property, which First Family conveyed to it after taking the deed. No statutory section, regulation or administrative practice provides for such notification.

[10] *Sitzman* v. *National Life & Accident Ins. Co.*, 182 N.E.2d 448 (Ind. App. 1962), concerned whether an insured under a life insurance policy providing benefits for the

loan benefits uses the term "loss" in the context of foreclosure: "[I]f the prior loan was foreclosed and the VA paid the claim, the veteran must repay in full any loss suffered by the VA on such loan." S. Rep. No. 1334, 93d Cong., 2d Sess. 21 (1974).

Petitioner next contends that the guaranty claim paid after the conveyance of the deed in lieu of foreclosure was not a loss because the VA "was in complete control of the situation" and made its decision "with full knowledge that a deficiency would result." Pet. 11. The VA, however, did not cause, encourage, or otherwise contribute to the default on the loan. Authorizing First Family to accept the deed was no more a self-inflicted wound than was authorizing foreclosure. In fact, acceptance of a voluntary deed may have mitigated the VA's loss.[11] In either

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accidental "loss of eyesight" may collect such benefits for loss of sight in one eye only. *Littrell* v. *Allemannia Fire Ins. Co.*, 226 N.Y.S. 243 (App. Div. 1928), addressed whether an appraisal was required before collecting under a fire insurance policy for property that was totally lost rather than merely damaged. *Providence Journal Co.* v. *Broderick*, 104 F.2d 614 (1st Cir. 1939), held that a taxpayer suffered no deductible loss for income tax purposes from the voluntary demolition of a building. None of those cases suggests that the amount paid by the VA on First Family's claim does not constitute a "loss" to the VA.

[11] Both the General Accounting Office and the VA Inspector General audited the VA home loan program in the mid-1980s and concluded that the VA should encourage the use of deeds in lieu of foreclosure as a cost-saving measure. The Inspector General estimated that in Fiscal Year 1985 the VA, through more aggressive action, could have accepted approximately 4800 additional voluntary deeds, saving the taxpayers about $16.2 million. S. Rep. No. 204, 100th Cong., 1st Sess. 32 (1987).

event, the VA was obligated to make First Family whole within the limits of the guaranty.

4. Finally, petitioner argues (Pet. 12-13) that the transfer of the deed in lieu of foreclosure while he was on active duty violated the Soldiers' and Sailors' Civil Relief Act of 1940, 50 U.S.C. App. 501 *et seq.* That Act suspends various civil liabilities of persons in military service. Petitioner relies mainly upon Section 525, which provides that the "period of military service shall not be included in computing any period * * * provided by any law for the redemption of real property sold or forfeited to enforce any obligation, tax, or assessment." Petitioner's invocation of Section 525 depends upon his argument that he had a right to redeem the property at the time the deed was conveyed in lieu of foreclosure. The court of appeals correctly ruled, however, that, under Ohio property law, petitioner had no right of redemption. Petitioner's claim under the Soldiers' and Sailors' Civil Relief Act thus adds nothing to the case and does not merit review.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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